

AD/NE

~~SECRET~~

CONFIDENTIAL

**CENTRAL INTELLIGENCE AGENCY
OFFICE OF NATIONAL ESTIMATES**

25 June 1951

Memorandum for the Director of Central Intelligence

Subject: Adverse Economic Effects on Non-Communist
Countries of an Embargo on Trade with China.

25X1

25X1

[redacted] question of whether a complete economic blockade or a naval blockade of China might not do certain non-Communist countries more harm than it would China.* Examination of information bearing on this question indicates that, although a total embargo might have critical political repercussions in some countries, it would not create serious economic difficulties. In fact, in terms of total national economies the economic effects would be negligible in all but three or perhaps four countries.**

2. There are a number of countries - particularly Pakistan, Ceylon and Indonesia - where specialized regions and where individual firms might suffer financial reverse. Many of these

25X1

[redacted]
**For the economic effects on China, see OIR Report No. 5447, 26 January 1951, "Vulnerability of the Soviet Bloc to Existing and Tightened Western Economic Controls" and NIE-22, 19 February 1951, "Vulnerability of the Soviet Bloc to Economic Warfare."

25X1

JUN 25 1951
NE-7

~~SECRET~~

~~CONFIDENTIAL~~

~~SECRET~~

CONFIDENTIAL

reverses would be in the nature of a reduction in abnormal profits which have risen recently out of the East-West armaments race. From the viewpoint of US security, however, any such financial reverses would be serious only insofar as they would aggravate the political difficulties of imposing and enforcing the embargo.

3. Of greater concern to the economic side of the question would be the effects upon Hong Kong and Japan. In Hong Kong economic activity would be greatly depressed, so that British subsidy might be necessary, and in any event the community's vulnerability to Communism would be heightened. In Japan there would have to be a substantial readjustment in the pattern of imports and exports. The loss of Chinese coking coal and iron ore would boost the cost of Japanese steel production, with the inevitable result that prices would tend to rise, including the prices of many export commodities. But alternative markets could be found, and raw materials in adequate quantities probably could be made available for Japanese import, although US allocations would probably be necessary.

4. The enclosure presents a summary of the economic evidence supporting these conclusions.

- 2 -

~~SECRET~~

~~SECRET~~
CONFIDENTIAL

ENCLOSURE

1. The Importance of Trade with China.

While the total foreign trade of China with non-Communist countries has grown rapidly under Communist direction, from a Western viewpoint it is not large. Chinese imports in 1950 have been estimated to be equivalent in value to \$480 million and exports to \$400 million, with no area aside from Hong Kong peculiarly dependent upon this trade.

a. Loss of Imports from China.

There are two measures for determining the degree of loss incident to an embargo: first, the cost of losing Chinese commodities; and second, the financial set-back involved in closing the China market. With respect to the former, loss of imports from China, it is clear that the adverse effects would be insignificant around the globe, except with a nominal number of private dealers whose lucrative trade would suffer, and in Japan where costs of production would probably rise. From a global standpoint Chinese commodities are "essential" only in the sense that they will do a somewhat better job at a slightly lower cost than readily available substitutes. China is the world's foremost producer of tungsten and tungsten is in tight supply in the West, but the Communist regime has banned its shipment to the West. The composition of Chinese exports is now primarily one of agricultural products and textiles. Bristles, textile manufactures, foodstuffs, tung and other vegetable oils, animal and poultry products, soybeans, fruits and nuts, tea, and peanuts are the major exports. Although some of these items are in high demand in the various importing countries, none are indispensable.

~~SECRET~~

~~SECRET~~

CONFIDENTIAL

b. Loss of the Export Trade to China.

With respect to financial set-backs which would be encountered by the non-Communist powers in an embargo on China, only Britain would undergo any real strain (because of its position in Hong Kong), and only Pakistan and Malaya would be forced to undertake a sizeable reorientation of trade. With the embargo limited to China, there would be no general distortion of trade, nor serious payments problem. As world demand is high for those goods which China imports, the exporting countries would encounter no difficulties in redirecting their trade elsewhere.

2. Japan.

In Japan the loss of the relatively small quantity of resources now provided by China would result in some increases in the cost of production, particularly in the steel industry. Roughly 25 percent of Japanese coking coal and 6 percent of iron ore requirements are now supplied from China, and alternative sources would be more expensive, boosting the cost of steel production. In the present world context, however, a rise in the price of Japanese steel, even if contributory to an increment in the price of Japanese export commodities, would not be seriously damaging. With world-wide shortages of steel manufactures and machinery, the market for Japanese exports is not at present sensitive to small price changes. Maintaining an adequate inflow of coking coal and iron ore would also be a problem, but not an insolvable one. The alternative source for these materials is the Western Hemisphere, primarily the dollar area. Since both coking coal and iron ore are in short supply, some US materials allocations would probably be necessary. In the long run, it is

- 4 -

~~SECRET~~

CONFIDENTIAL

~~SECRET~~**CONFIDENTIAL**

true that Japanese-Chinese trade may be of tremendous importance in enabling the Japanese to meet international competitive prices. But this thesis assumes a peaceful world will materialize; meanwhile, the outlook for expansion of Japanese trade is excellent, even without low-cost Chinese raw materials, though realignment of Japanese trade would constitute a problem.

3. Hong Kong.

The British would have a serious problem maintaining their position in Hong Kong. Inasmuch as the Hong Kong-Chinese trade is the backbone of Hong Kong life (exports to China in 1950 were equal in value to \$258 million, or 39 percent of Hong Kong's exports to all countries), economic activity in Hong Kong would be greatly depressed. British subsidy might be necessary; the community would become more vulnerable to a Communist coup; and the likelihood of an armed invasion would certainly increase when the value of the community to the Chinese Communist became nullified.

4. Western Europe.

Throughout Western Europe trade with China and Hong Kong is slight. Even British exports to Hong Kong and the Chinese mainland amounted to only \$88 million, less than 1½ percent of total British exports. Since some British products are consumed in Hong Kong, not all of these goods reached China. The bulk of the trade covered iron and steel manufactures, machinery, electrical equipment, non-ferrous metals, vehicles and vessels, and tires, for which alternative markets could in due time be found. Statistics on West German foreign trade last year show China

~~SECRET~~

~~SECRET~~
CONFIDENTIAL

and Hong Kong together as accounting for 1.2 percent of total exports, almost entirely iron and steel products and chemicals. Similarly, China and Hong Kong received 1.1 percent of Belgian exports, in great part iron and steel products. Swiss exports to the area, watches and other manufactured items, made up 2 percent of total Swiss exports. In no other country of Western Europe are marketing operations in Hong Kong and China of measurable significance. Closure of these markets would hardly be noticed in Western Europe, at least from an economic viewpoint.

5. South and Southeast Asia.

In several South and Southeast Asian countries exports to China and Hong Kong represent a somewhat greater percentage of total trade than is the case elsewhere in the world. These percentages are as follows for 1950: Pakistan, 12.9 percent (January-June); Malaya, 4.2 percent (January-August); India, 2.8 percent (January-December). It has been estimated that in the year ending August 1950 approximately one-third of Pakistan's raw cotton exports made their way to China. Reports from trade circles in Karachi have indicated that Chinese buyers are prepared to pay whatever the Pakistanis ask for raw cotton. Hence, one may presume that a realignment away from such trade would mean some diminution of profits, though there can be no doubt that any exportable surplus of cotton can be distributed at favorable prices in the West. The same is true of Pakistani jute, which the Chinese import in smaller amounts. In recent years about 90 percent of China's recorded imports of rubber have come from Malaya, and shipments have increased considerably since July 1950. Yet, with a heavy demand from the West, a closure of the China market would not be of greater significance to

~~SECRET~~

~~SECRET~~**CONFIDENTIAL**

Malaya. While Indian cotton textiles, jute sacking and gunny bags are in heavy demand by the Chinese, these commodities are also in short supply in the West, so that a realignment of Indian exports could be accomplished rapidly and at small cost in monetary determinations. The trade of the remaining countries of Southeast Asia with China has receded to inconsequential proportions since the collapse of the Nationalist government. This is true of Indonesia, as well as other countries, despite a prevalent misconception to the contrary.

Only quite small quantities of Indonesian exports, usually well under 1 percent of total exports, find their way to China. The large shipments of Indonesian rubber to Malaya (including Singapore) would be perhaps slightly contracted, both in quantity and value, if the China embargo caused a drop in rubber prices in Malaya. But such a contingency is not anticipated, considering the heavy demands for rubber in Eastern Europe and the West.

6. Other Areas.

The cost of closing the China market would be even slighter in Latin America than it would be in Europe. A few very small exports of Chilean copper to China, small quantities of Cuban sugar, some evidence of Chinese Communist attempts to get Venezuelan oil via Hong Kong (shipment of Venezuelan oil to Communist countries is illegal), some cotton from Brazil, and coins and precious metals in small quantity from Mexico--these, and not much else, have constituted Latin American exports to China and Hong Kong in the past two years.

~~SECRET~~**CONFIDENTIAL**

~~SECRET~~

CONFIDENTIAL

In the Middle East, the only country to be affected in the slightest would be Egypt, whose 1950 exports included shipments to China valued at \$3.5 million, presumably long-fibre cotton. This was less than 1 percent, however, of total Egyptian exports. African foreign trade statistics register only the Union of South Africa as having trade with Hong Kong; its value was \$2.5 million, less than $\frac{1}{2}$ of 1 percent of the country's total exports. No other African countries are recorded as exporting directly to China.

Only Australia and Canada remain to be considered. Exports to China and Hong Kong accounted for less than one-third of one percent of total Canadian exports in 1950; for Australia the figure is a flat one percent. Since both are countries with modern, flexible economies, one can be assured that little if any difficulty would be sustained from the loss of these markets.



25X1

WILLIAM L. LANGER
Assistant Director
National Estimates

~~SECRET~~

CONFIDENTIAL